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CORPORATE RESEARCH FORUM

2020 MEETING  
RETROSPECTIVE

# **GROW THE PIE:**

HOW GREAT COMPANIES DELIVER  
BOTH PURPOSE AND PROFIT

17 JUNE 2020, VIRTUAL



# GROW THE PIE: HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT

Corporate Purpose is a concept that is very much in vogue at the moment and one that has become wrapped up with concerns about business ethics and the environmental and social responsibilities of companies. Much of the conversation suggests, at least implicitly, that there is a trade-off between being a socially responsible organisation and making profits. **Alex Edmans**, Professor of Finance at London Business School, doesn't agree. His latest book, ***Grow the Pie: How Great Companies Deliver Both Purpose and Profit***, argues that business can be a force for good and that profits are critical to a well-functioning economy. On 17<sup>th</sup> June, Alex led a webinar for CRF and PARC members in which he discussed his findings with particular relevance to incentives and reward.

The distinction between investors and the rest of society, says Alex, is flawed even at a conceptual level. While it's crucial for companies to serve society, they also have a duty to generate sustainable profit for the vast majority of us who depend on them to look after our employment, our savings, and our future income in retirement. Investors are not 'them'; they are 'us'. It's not business or society – it's business and society.

Alex used the example of Vodafone's m-pesa system that has generated profits for the company while, at the same time, enabling people in rural parts of Kenya to store money securely and reduce their dependence on banks, thereby helping to lift 200,000 people out of poverty. The answer is not



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Corporate Social Responsibility for its own sake. The way forward is to grow the size of the economic pie by solving social problems and generating profit as a result. Or, to put it another way:

*"Pieconomics seeks to create profits only through creating value for society."*

The book is full of evidence and case studies of companies that grow the pie. In this sense, says Alex, 'responsibility' is actually about innovation and creating value for society, which generates greater profits over the long term. While there is ample data and evidence in the book to back this up, for this session, Alex focused on what this means for companies and, specifically, for reward and performance management.

As most reward practitioners are well aware, executive pay has attracted a lot of attention and the post-Covid-19 environment is likely to bring it into even sharper focus. Yet the concern about pay ratios, argues Alex, misses a crucial point. It implies that there is a fixed pie. There is clear evidence that



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firms with high pay ratios perform better over the long term. But crucial to this is the composition of executive reward. Long-term incentive plans, he argues, should be based on ensuring that executives acquire and hold more equity in their companies:

*"Firms with high equity incentives beat those with low equity incentives by 4-10%/year."*

The problem with the design of many LTIPs is that the vesting date of the award can induce cuts in investment in R&D and capital expenditure and a focus on earnings targets, as senior executives try to manipulate the achievement of a specific target or performance condition. By contrast, he argues, long-term equity based compensation improves return on assets, net profit margin, sales growth and, crucially, innovation. It is this that, in turn, improves the performance of the company for wider stakeholders.

Replacing LTIPs with equity ownership also has 'the remedy of simplicity'. There is no need to use performance metrics, weightings and targets. The long-term performance of the share price captures almost all measures of performance. It also more closely aligns the interests of senior executives with investors and gives them more 'skin in the game'. Alex provided links to studies demonstrating that companies with a higher proportion of equity ownership in their remuneration packages beat the performance of their peers over a five-year period.

There will, he acknowledged, always be a place for an element of annual bonus-related targets. There are certain business priorities that need to be addressed over a shorter time-frame. He used the example of reducing the use of plastic bags. It would be unrealistic to measure and reward every business priority via long-term stock performance. Nevertheless, there is strong evidence that a greater element of equity in executive reward would lead to a focus on the sort of behaviours and innovations that create both profits and increased value for society.

**In the face of perceived conflict between business and society, his is a fundamentally optimistic analysis. Yet this optimism is not based on blind hope, but on rigorous evidence and an actionable framework to turn it into reality.**

### SPEAKER

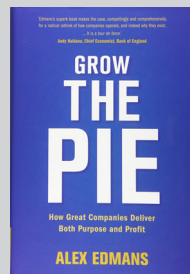


@aedmans

### PROF. ALEX EDMANS

**Professor of Finance at London Business School**

Alex Edmans, Professor of Finance at London Business School and Academic Director of the Centre for Corporate Governance, who focuses on corporate governance, responsible business, and behavioural finance. He is also an elected member of the Governing Body. Alex graduated from Oxford University and then worked for Morgan Stanley in investment banking (London) and fixed income sales and trading (New York). After a PhD in Finance from MIT Sloan as a Fulbright Scholar, he joined Wharton in 2007 and was tenured in 2013 shortly before moving to LBS.



### GROW THE PIE

**by Alex Edmans**

Available to buy [here](#).

*Financial Times Business Book of the Month, March 2020.*

ACCESS THE SESSION SLIDES:

[HERE](#) (VIA PARC), [HERE](#) (VIA CRF).

### UPCOMING EVENTS

crf	<b>Leading For Recovery And Renewal</b> , with Prof. Gianpiero Petriglieri	Thur. 25 June, 12.00 – 13.00	
crf	<b>HRBPs: Their Role In Reset And Thrive</b> , with Neil Morrison	Wed. 1 July, 12.00 – 13.00	
parc	<b>How Culture Impacts Attitudes to Risk</b> , with Anette Mikes	Wed. 8 July, 12.00 – 13.00	
crf	<b>Thriving After a Crisis</b> , with Prof. Howard Yu	Fri. 10 July, 12.00 – 13.00	
crf	<b>The Agile Dashboard</b> , with Joe Perfetti	Wed. 22 July, 12.00 – 13.00	
parc	<b>Radical Uncertainty</b> , with John Kay	Wed. 12 August, 12.00 – 13.00	



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